Supreme Court, U.S.
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Nos. 97-550 and 97-591

# In the Supreme Court of the United States

OCTOBER TERM, 1997

DFA INVESTMENT DIMENSIONS GROUP INC., ET AL., PETITIONERS

*v.*

MUNFORD, INC.

DANNE' BROKAW MUNFORD, ETC., ET AL., PETITIONERS

*v.*

MUNFORD, INC.

*ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT*

## BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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## QUESTION PRESENTED

Whether payments made to and by a bank that acts as an exchange agent for a corporate merger transaction are "transfers" that may be protected, under 11 U.S.C. 546(e), from avoidance and recovery in a subsequent bankruptcy proceeding involving the corporation that survived the merger.

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## OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-22)[1] is reported at 98 F.3d 604. The opinions of the district court (Pet. App. 23-51) and the bankruptcy court (Pet. App. 52-110) are unreported.

[1] References are to the appendix to the petition in No. 97-550.

## JURISDICTION

The judgment of the court of appeals was entered on October 28, 1996. A petition for rehearing was denied on July 9, 1997. The petitions for a writ of certiorari were filed on September 26, 1997 (No. 97-550) and October 3, 1997 (No. 97-591). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATEMENT

Respondent Munford, Inc. operated three chains of specialty and convenience stores. Pet. App. 2. Before the transaction at issue in this case, respondent's shares were publicly held and listed on the New York Stock Exchange. *Id.* at 4-5 & n.1. In November 1988, an investor group acquired all of respondent's outstanding shares in a transaction, approved by respondent's 3,100 shareholders, in which each of the 3.9 million shares not already held by the new investors was converted into a right to receive a cash payment of $17 per share. *Id.* at 4-5, 59. To effectuate the transaction, respondent and the new investor group borrowed and deposited the necessary funds with a bank, which then made appropriate payments to respondent's shareholders in exchange for their shares. *Id.* at 4, 10, 12, 81-82.

Thirteen months after the transaction, respondent filed for bankruptcy. Pet. App. 5. As part of its bankruptcy case, respondent filed an adversary proceeding seeking to recover, as voidable transfers, payments totalling approximately $10.8 million made, in the buy-out transaction, to two groups of former shareholders, including a group of related pension-fund investors (petitioners in No. 97-550) and certain former officers and directors of respondent (petitioners in No. 97-591). *Id.* at 5-6.

Petitioners moved for summary judgment in the adversary proceeding on the ground that 11 U.S.C. 546(e) precluded recovery of the payments in question. Under Section 546(e), a trustee or debtor-in-possession may not, in the absence of proof of actual intent to defraud creditors, "avoid a transfer that is a * * * settlement payment, as defined in section * * * 741 * * *, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency." Section 741 of the Bankruptcy Code, 11 U.S.C. 741, defines the term "settlement payment" to mean any of a variety of types of settlement payment "or any other similar payment commonly used in the securities trade."

The bankruptcy court concluded that petitioners' motions for summary judgment should be denied. Pet. App. 6-7, 81-91. The district court, however, held that petitioners were entitled to summary judgment on their claim that Section 546(e) barred recovery. *Id.* at 32-37. On appeal to the Eleventh Circuit, the Securities and Exchange Commission filed a brief arguing that the district court's decision on the Section 546(e) issue should be affirmed.[2]

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[2] The Commission participated in this case pursuant to 11 U.S.C. 1109(a), which provides that the Commission "may raise and may appear and be heard on any issue in a case under" Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101 *et seq.* The Commission acts as an advisor to the court and seeks primarily to protect the interests of public investors. Although the Commission may not file its own appeals under Section 1109(a), it may appear in appeals brought by other parties, as it did in this case. The Commission also filed a brief supporting petitioners' request for rehearing and suggestion of rehearing en banc in the court of appeals.

The court of appeals reversed the district court's decision construing Section 546(e). Pet. App. 1-13, 20. The court acknowledged that the bank that acted as exchange agent in the buy-out transaction was a "financial institution" for purposes of that Section, and it "presume[d]" that the payments in question were "settlement payments." *Id.* at 12. The court held, however, that the transaction had involved no "transfer" made "by or to" the bank for purposes of Section 546(e), because the bank served as "nothing more than an intermediary or conduit" for transfers or payments "made *by* [respondent] *to* shareholders." *Ibid.* In the court's view, because the bank "never acquired a beneficial interest in either the funds or the shares" exchanged in the transaction, "it was not a 'transferee'" of respondent's funds; the only "transferees" were respondent's former shareholders, and "section 546(e) offers no protection * * * to shareholders." *Id.* at 12-13.

Chief Judge Hatchett dissented from the court's holding under Section 546(e). Pet. App. 21-22. In his view, the court had "chose[n] to disregard the plain language of section 546(e) in order to create a new exception to its application." *Id.* at 22. He would instead have held that the payments in question were "settlement payments" made to shareholders by a "financial institution," and were therefore protected by Section 546(e). *Ibid.*

## ARGUMENT

1. In the absence of proof of actual intent to injure creditors, 11 U.S.C. 546(e) precludes the avoidance in bankruptcy of any "transfer" that is a "settlement payment" made "by or to" a participant in the national securities clearance and settlement system. Section

101(54) of the Bankruptcy Code defines the term "transfer" to include "every mode * * * of disposing of or parting with property or with an interest in property." 11 U.S.C. 101(54). Congress intended that term to be "as broad as possible"; and "any * * * transfer of possession, custody, or control [is a transfer] even if there is no transfer of title, because possession, custody, and control are interests in property." S. Rep. No. 989, 95th Cong., 2d Sess. 27 (1978); H.R. Rep. No. 595, 95th Cong., 1st Sess. 314 (1977). In this case, therefore, there was a "transfer" of cash by respondent to the bank as exchange agent for the buy-out transaction, and a further "transfer" by the bank to respondent's former shareholders, including petitioners.

The court of appeals held, to the contrary, that there was no "transfer" in this case because "[t]he bank never acquired a beneficial interest in either the funds or the shares." Pet. App. 12. That rationale (which the court adopted sua sponte, without the benefit of briefing or argument) finds no support in the language or purposes of Section 546(e). Indeed, Section 546(e) was enacted in order to protect entities that act as "conduits" between buyers and sellers in clearing and settling millions of securities transactions every year, as well as the buyers and sellers themselves, from the uncertainty and disruption in the securities markets that could otherwise be caused by the risk or actuality of bankruptcies affecting market participants.[3] Holding Section 546(e) inappli-

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[3] Section 546(e)'s statutory predecessor was enacted in 1978 to rectify problems caused in the commodities markets by the decision in *Seligson* v. *New York Produce Exchange*, 394 F. Supp. 125 (S.D.N.Y. 1975), in which the trustee for a bank-

cable to payments made by or to brokers, clear-ing agencies, or financial institutions whenever they could be characterized as acting as "conduits," rather than as principals, would largely nullify the statute.[4]

2. The decision below rests on an interpretive error that may at some point call for this Court's review and correction. In our view, however, the matter is not presently ripe for review.

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rupt commodities broker sought to avoid and recover $12 million in margin payments that the broker had made to a commodities clearing association. The association contended that it could not properly be considered the transferee of the margin payments, because it was acting only as a "conduit." The district court denied the association's motion for summary judgment. Congress's response to the uncertainty engendered by that decision was to enact 11 U.S.C. 764(c) (Supp. II 1978), which protected commodities margin and settlement payments from being recovered as fraudulent transfers or preferences. See S. Rep. No. 989, *supra*, at 106. Section 546(e), enacted in 1981, extends that protection to include the securities markets.

[4] The court misplaced reliance (Pet. App. 12) on *In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1200-1201 (11th Cir. 1988). That case held that a bank was not, on particular facts, an "initial transferee" from whom a trustee could actually recover, under 11 U.S.C. 550(a), a transfer that the court assumed (see 848 F.2d at 1198-1199) was properly avoidable under the substantive fraudulent conveyance rules of 11 U.S.C. 548. The issue in this case is whether a very different sort of transfer may properly be avoided under the substantive rule of Section 546(e). It would be ironic to apply a principle developed to protect financial institutions from recovery as "transferees" under Section 550(a) to prevent the same institutions from obtaining the benefit of Section 546(e), which was enacted specifically in order to protect them in situations in which their primary role is to faciliate the operation of the securities markets by acting as secure and neutral "conduits" in the execution of transactions among arm's-length buyers and sellers.

Petitioners contend (97-550 Pet. 10-12; 97-591 Pet. 9-11) that the decision in this case conflicts with the Tenth Circuit's decision in *Kaiser Steel Resources, Inc.* v. *Pearl Brewing Co.*, 952 F.2d 1230 (1991), cert. denied, 505 U.S. 1213 (1992). It is fair to say that the two cases involved similar facts, and that the courts reached different conclusions about whether Section 546(e) precluded the avoidance and recovery of payments made by a corporation to former shareholders in a buy-out merger. The decisions are, however, analytically distinct.

*Kaiser Steel* held principally—and correctly—that buy-out payments made to former shareholders through one of the intermediaries listed in Section 546(e) are "settlement payments" for purposes of that provision. 952 F.2d at 1236-1240; see 91-1607 S.E.C. Br. in Opp. 7-13. The court of appeals in this case appeared to agree with that holding, although it declined to pass on the issue, instead "presum[ing]" that the payments in question were "settlement payments." Pet. App. 10-12 & n.4. The court below based its refusal to apply Section 546(e) on the quite different ground that the payments at issue in this case involved no "transfer" of funds to or from the exchange-agent bank, because the bank acted only as a "conduit," and "never acquired a beneficial interest in either the funds or the shares." *Id.* at 12. That question was not raised or decided in *Kaiser Steel.*[5]

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[5] Indeed, the financial institution defendants in *Kaiser Steel* were ones that *did* beneficially own the Kaiser shares that they tendered, and for which they received payment, in the transaction at issue in that case. See 952 F.2d at 1236. Another case arising from the Kaiser Steel transaction, *Kaiser Steel Corp.* v. *Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990), held Section 546(e) applicable to payments made to a broker that

As we have discussed, the court of appeals' restrictive interpretation of the word "transfer" in Section 546(e) is incorrect. If widely adopted and applied, it could undermine the effectiveness of Section 546(e) in achieving Congress's purpose of protecting participants in the securities clearance and settlement system and the stable and efficient functioning of the securities markets. That purpose is best achieved by safeguarding settlement payments, under most conditions, from avoidance and recovery in the event of bankruptcy on the part of any party or intermediary involved in the transaction. Nonetheless, the court of appeals adopted its novel theory without the benefit of briefing and argument, and the matter has not been addressed by any other court of appeals. Review by this Court at the present time would therefore be premature.

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acted solely as an intermediary in the transaction. In that case, the intermediary made an argument similar to the theory adopted by the court of appeals in this case—that it functioned solely as a "conduit" and therefore should not be treated as a "transferee" under 11 U.S.C. 550(a). 913 F.2d at 848; see also note 4, *supra*; *Kaiser Steel*, 952 F.2d at 1236. The *Schwab* court did not, however, reach the "conduit" argument. 913 F.2d at 848.

## CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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